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REGIONAL MULTINATIONALS AND THE KOREAN COSMETICS INDUSTRY

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ABSTRACT

This paper analyzes the market penetration and expansion strategy of cosmetics and toiletries multinational enterprises (MNEs) in South Korea from the perspective of regional strategy as developed recently by Rugman. We find that MNEs have different market entry and expansion strategies in the home region and in the foreign region. Home region MNEs (Japanese MNEs in this case), in general, utilize their firm-specific advantages (FSAs) better than foreign region MNEs (European and MNEs from the Americas in this case). Due to differences in transaction costs, home region MNEs exploit downstream FSAs while foreign region MNEs develop upstream FSAs. Market similarity also leads to a greater incentive to operate in the home region rather than in foreign regions. The home region effect significantly increases the likelihood of entry into foreign markets as the host country's "diamond" significantly affects the market entry strategies of MNEs.

Keywords: regional strategy, market penetration, cosmetics industry, double diamond, South Korea.

INTRODUCTION

Today it is recognized that firms expand internationally mainly into nearby countries in their home region. Rugman (2000, 2005) and Rugman and Verbeke (2004) show that the great majority of world trade, foreign direct investment (FDI) and sales by large firms take place within the three broad triad blocks of Asia, NAFTA and the EU, rather than between them. Using data on the intra-regional sales of the largest 500 firms and case studies of many of these firms it has been demonstrated that most multinational enterprises (MNEs) have not realized a global strategy but rather a home region-based strategy.

In Rugman (2005), a home region firm is defined as one with over 50% of its sales in its home region (for example, Wal-Mart has 94% of its sales in North America). A global firm is defined as one with at least 20% of its sales in each of the broad triad regions, and less than 50% in its home region (an example is LVMH). A bi-regional firm has at least 20% of its sales in two regions of the triad but less than 50% in its home region (examples are the Belgian retailer Delhaize le Lion and the Dutch firm Royal Ahold). In this paper we focus on the 100 largest cosmetics firms: in these there are only Japanese and Korean firms present in Asia. The foreign firms in the Korean cosmetics industry include those from Japan, United States, EU, Canada, and Brazil.[1]

The basic theory of international management states that MNEs seek an optimal balance of economic integration and national responsiveness (Bartlett & Ghoshal, 1998; Rugman & Hodgetts, 2001). In doing so MNEs have an incentive to enter home region countries. In the home region MNEs benefit from lower transaction costs than in foreign regions of the triad. This

[1] In this article home region countries mean foreign countries in the same region of the triad. In Asia, with mainly Japanese MNEs, South Korea is one such home region country.

occurs due to institutional factors such as: geographic adjacency; cultural similarity; market knowledge; and regional government regulations (as in NAFTA and the EU), etc. This type of analysis is broadly consistent with related theories such as: the eclectic theory (Dunning, 1988); evolutionary theory (Nelson & Winter, 1982); the organizational capability perspective (Kogut & Zander, 1993); and internalization theory (Buckley & Casson, 1976; Rugman, 1980).

Previous market entry studies can be categorized into three broad perspectives: internalization theory, evolutionary theory, and the eclectic theory. Internalization theory is a transaction cost theory of the MNE (Rugman, 1981) whereby firms best utilize FSAs and country specific advantages (CSAs) (Buckley & Casson, 1976, 1998). [2] Evolutionary theory focuses on organizational capability and learning. This view advocates a gradual involvement in the foreign market (Johansson & Vahlne, 1977; Lambkin, 1988; Kogut & Zander, 1993; Madhok, 1997; Pan & Tse, 2000). The eclectic theory integrates international business theories and highlights ownership specific, location specific, and internalization advantages (Dunning, 1988; Agarwal & Ramaswami, 1992; Kim & Hwang, 1992; Woodcock, Beamish & Makino, 1994). The recent linkage-leverage-learning global framework by Mathews (2006) in a previous article in this journal is somewhat superseded by the regional strategy theory of Rugman and Verbeke (2004). In addition, Rugman and Verbeke (2001, 2003) and Verbeke (2003) have shown that the resource based view (RBV) is fully consistent with the transaction cost economics (TCE) theory of the MNE; indeed it is a sub case of internalization theory.

The fundamental questions of MNEs' entry strategies need to be re-examined in the context of the new regional MNE theory. What are the differences in entry strategies between home region MNEs and host region MNEs in a host market? How do non-location bound FSAs

[2] Rugman and Verbeke (2003) point out that the transaction cost theory and the resource-based view are same.

and local responsiveness affect market entry decisions of MNEs? We answer these questions, in particular, by presenting the case of the South Korean cosmetics market. Some earlier work also implicitly discusses the regional strategy of market entrance and expansion. For instance, Aharoni (1966) concludes that firms analyze only a limited number of foreign markets initially, and gradually expand their outlook to other foreign markets. Davidson (1983) suggests that similarities in supply, demand, and uncertainty encourage foreign entry. The basic principle behind this approach holds that increased efficiency in international marketing can be gained by clustering markets into similar geographic groups.

This study contributes across two dimensions. First, we investigate the market entry mode strategies of MNEs from a regional strategy perspective. Both in market entry and also in subsequent expansion the MNEs' home region strategy should be distinguished from that of foreign region MNEs. Secondly, we empirically examine the CSAs in terms of the "diamond" (Porter, 1990), and we find that the home region effect, as well as the FSAs and local responsiveness to CSAs, significantly increases the likelihood of entry of cosmetics MNEs into the South Korean market. Market entry research is a classical topic in international strategic management (Melin, 1992; Peng, 2001). Peng (2001) actually suggests that research on the actual channels (modes) of entry is necessary to integrate the RBV with TCE theory. Bearing this in mind, here we analyze actual entry modes (levels of control) and the effects of marketing channels in the home and host country on the entry strategy of MNEs in the South Korean cosmetics market.

Examining the South Korean cosmetics market is important and relevant because it is growing rapidly and is a base for cosmetics MNEs' competition. The cosmetics industry is an interesting theoretical research topic in itself as cosmetics products have the characteristics of

both chemical products and consumer care products, so cosmetics firms have both upstream and downstream FSAs.

The article is organized as follows. In the next section, we will review key background information about the world cosmetics industry and the cosmetics market in South Korea. Sources and description of our data are also introduced. After presenting several research hypotheses concerning the regional characteristics of cosmetics MNEs and regional strategy, we report our findings. We conclude with a discussion of the contribution and possible extensions of this study.

The Cosmetics Industry

The Global Cosmetics Industry

In this paper, we focus on the internationalization strategy of the world's largest 100 cosmetics companies. The list of the world's largest 100 cosmetics companies and its sales comes from Woman's Wear Daily (WWD) magazine and is reported in Appendix A. WWD annually reports on the largest 100 cosmetics companies based on sales. The cosmetics industry is regionally based, with firms based in North America and in West European countries each accounting for approximately 43% of it. Firms based in Japan and South Korea also have substantial market share at 14%.[3] Firms in the largest five countries (the United States, the U.K., France, Germany and Japan) make up 93% of sales in our sample.

[3] We compare the sales from WWD and firms' annual reports if both are available. The values are almost identical in either source excluding a few possible rounding errors.

Using Rugman's (2005) classification of regional multinationals based on intra- and inter-regional sales, only 16% of cosmetics MNEs actively participate in at least one foreign triad market. The sales evidence is confirmed when we use data on the geographic dispersion of assets. All cosmetics MNEs, except Unilever, invest more than 50% of assets in their home region, and the average of their intra-region assets is 84%. In particular, small MNEs invest an average of 92.6% assets in the home region, and all of them are therefore categorized as home region oriented MNEs based on their geographic dispersion of assets.[4]

The retail distribution channels of cosmetics products vary by product and consumer characteristics, such as department stores, discounters, grocery, pharmacy, direct sales, etc. We categorized the distribution channels into four types based on retailer types: direct sales; specialty stores; mass merchandisers; and the other channels.[5] These categories also reflect local responsiveness. Direct sales channels depend on an individual's abilities as well as market and consumer information, while mass merchandisers do not require this as much. Specialty stores are positioned somewhere between direct sales and mass merchandisers with the salesperson's ability more important in the specialty stores channel than in the mass merchandise channel. Sales by distribution channels vary with the consumer characteristics of each country. The average percentages of world sales by retail channels are 10%, 13%, 53%, and 24% for direct

[4] The average sales of Rugman's 380 companies was $29.2 billion, while the average sales of our total sample is $5.8 billion. We divide the largest 100 cosmetics companies into large MNEs and small MNEs based on their sales in 2003. Sales of large MNEs are at least $1 billion in 2003, while those of small MNEs are less than $1 billion. In this way 34 companies are categorized as large MNEs among cosmetics companies, while 66 companies are categorized as small MNEs.

[5] Specialty stores offer merchandise in one line with great variety at a price comparable to those of a department store (Coughlan, Anderson, Stern & El-Ansary, 2001). Sephora is a good example of a cosmetics specialty store. Mass merchandisers include department stores, grocery stores, discount stores, and hypermarkets. The other channels include drug stores, outdoor markets, etc.

sales, specialty stores, mass merchandisers, and the other channels respectively in 2002. (Euromonitor, 2003).

The Cosmetics Market in South Korea

The average growth rate of the cosmetics market in South Korea is about 11% for 1998 – 2003, which is higher than the average growth rate of the global market, 2%. The market share of imported cosmetics products is about 30% of the total cosmetics market in South Korea.[6] According to the Korean Cosmetics Association's 2004 report, total cosmetics imports have decreased 3% per year since 2001 on average. In contrast, cosmetics imports from Japan have increased 13% per year on average.

Among the largest 95 cosmetics companies (excluding five Korean cosmetics firms), 48 firms have officially entered the South Korean market.[7] We categorize the penetration and internationalization strategy into: no entry; exporting; licensing; joint venture (JV); and wholly owned subsidiary (WOS). These entry modes are widely tested in the literature (Agarwal & Ramaswami, 1992; Kim & Hwang, 1992; Buckley & Casson, 1998; Pan & Tse, 2000). Half of the one hundred largest cosmetics companies have entered the South Korean market, with 88% of the Japanese firms, 54% of the European firms and 38% of the U.S. firms there.

In 2002, the percentages of cosmetics sales by marketing channels in South Korea are:- direct sales (23%); specialty stores (34%); mass merchandisers (38%); and the other channels

[6] The market share of foreign branded products (including imported and locally produced foreign products) would be higher than 30%. A few large cosmetics MNEs have production units in South Korea through JV and WOS. For example, P&G, Revlon Inc., and Johnson and Johnson manufacture cosmetics products in South Korea.

[7] Foreign firms' activity data in the South Korean market come mainly from the Jang-up newspaper, a special weekly newspaper for the cosmetics industry and professionals.

(5%). The proportions of direct sales and specialty stores channels in the South Korean market are higher than the world average, while those of mass merchandisers and the other channels are lower than the world average. In other words, cosmetics retailing in Korea is more difficult for foreign MNEs than in other countries, because MNEs have to internalize high tacit and complex activities. MNEs need, in general, higher local responsiveness and stronger ownership structure of subsidiaries when they retail through salesperson oriented channels than when they sell through mass merchandisers.

RESEARCH HYPOTHESES

The conventional framework of RBV needs to be augmented, as operating in the home triad region may be associated with new needs for the development of regional bound FSAs, imposed by regional integration (Rugman & Verbeke, 2004). Previous evidence shows that MNEs use not global strategy but regional strategy, and it suggests that a regional bound FSA is easier to exploit than an FSA in foreign regions.[8] What kinds of benefits do home region MNEs have? The benefits would be firm and industry specific, but in general home region MNEs achieve more benefits (or fewer risks/uncertainty) than foreign region MNEs. The benefits can be summarized as low transaction costs and market similarity.

Transaction Costs

In the home region of the triad, MNEs can benefit from geographic closeness (minimizing transaction costs): economies of scale in sourcing, production, logistics, etc. Upstream FSAs

[8] See also Rugman and Girod (2003), Rugman and Collinson (2004), and Rugman and Collinson (2005).

occur mainly from economies of scale, with MNEs producing regional products rather than global products. Home region MNEs can endeavor to exploit location specific advantages (LSAs). Substantial research of the host market consumer is a prerequisite for successful introduction of new products (Vernon, 1971), but the costs of market entry and marketing operations can be reduced if marketing strategies and operations can be standardized for a set of similar markets (Davidson, 1983). Often, decentralization benefits will be smaller than centralization benefits during the early period of business in the home region country (based on transaction cost analysis) because of lower brand recognition and the small size of market share.

H1: Large MNEs prefer a high control mode (such as a subsidiary) to a low control mode (such as an alliance).

H2: Low transaction costs of home region MNEs make upstream investment unattractive when they enter into the host market.

On the other hand, since foreign MNEs have higher transaction costs than home region MNEs, they need to develop location bound FSAs. To overcome insufficient development of regional bound FSAs, foreign MNEs need to have non-regional bound FSAs, such as size, brand recognition, technological ability, organizational capability, multinational experience, etc. Therefore the economic integration and local responsiveness framework (Bartlett & Ghoshal, 1998) and/or the FSA and CSA framework (Rugman, 1981; Rugman & Verbeke, 1992) are useful in analyzing regional strategy. Recently Peng, Lee, and Wang (2005) apply a similar framework to analyze the scope of firms based on the institutional perspective. They propose a matrix that captures the importance of product relatedness and institutional relatedness. Since the firm's diversification strategy is a function of economic benefit and transaction costs, their

framework is consistent with the FSA and CSA framework of international business which underlies our analysis in this paper.

Agarwal and Ramaswami (1992) suggest that low control modes are considered superior for many transactions since they allow a firm to benefit from the scale economies of the market place, while not encountering the bureaucratic advantages that accompany integration. However, if the market is unable to provide competing alternatives and/or managers are unable to predict future contingencies, a low control mode will require a higher cost.

H3: High transaction costs lead foreign MNEs to exploit their upstream firm specific advantages from the beginning.

Johansson and Wiedersheim-Paul (1975) and Johansson and Vahlne (1977) present evidence, using four Swedish engineering firms, that firms gradually increase their control of subsidiaries. They find that no firms start production in a country without having first sold in the country via an agency or a sales subsidiary, and they claim that this is not exclusively a Swedish phenomenon. Peng, Au, and Wang (2001) apply the stages theory of internationalization to the governance structure of MNEs. They find that the demographic characteristics and governance patterns of boards of Thailand based MNEs are statistically different from those of Thailand based non-MNEs. Resources are needed for absorbing the high costs of marketing, for enforcing patents and contracts, and for achieving economies of scale. Non-location bound FSAs are the resource of the RBV. In the context of FDI, the non-location bound FSAs typically lead to scale or scope economies and can be transferred abroad at low marginal costs (Rugman & Verbeke, 2001). Firm size is an important non-location bound FSAs. Empirical evidence indicates that the impact of firm size on level of control is positive (Buckley & Casson, 1976; Caves & Mehra, 1986; Terpstra & Yu, 1988; Agarwal & Ramaswami, 1992).

H4: MNEs gradually increase their level of control of subsidiaries only when they have developed non-location bound FSAs (size).

Market Similarity

Rugman and Verbeke (2004) point out that the relative lack of market success in host triad regions can be interpreted, at least partly, as a reflection of the limited customer value attributed to home region FSAs, whether transferred through exports, licensing, or FDI. The international trade literature finds that common cultural characteristics increase interdependency between trade pairs, and Rugman and Hodgetts (2001) also show highly regionally concentrated international trade flows. Vernon (1971) suggests that demand for a product tends to be greatest in countries with markets similar to that for which the product was originally developed, *ceteris paribus*. Davidson (1983) finds that market similarity plays an important role in the market selection decision. In general, countries within the triad share somewhat related cultures and a common preference in goods. Moreover, multinational experience has been shown to influence entry decision. (Caves & Mehra, 1986; Anderson & Gatignon, 1986; Terpstra & Yu, 1988; Agarwal & Ramaswami, 1992; Woodcock, et al., 1994) Whether MNEs have a multinational experience or not, home region MNEs can enjoy the benefit of home market similarity (regional experience).

H5: MNEs from the home region have more location (downstream) FSAs in the local market, and they penetrate the market earlier than MNEs from foreign regions.

H6: Within the same region, firms which have non-location bound FSAs (large MNEs) enter the local market earlier than firms that do not have FSAs (small MNEs).

Market similarity should be examined not only at the regional level but also at the country, firm and product levels. Kogut and Zander (1993) demonstrate that firms choose a high control mode in cases of high knowledge tacitness, high complexity, and problematic teachability. High-control entry modes are preferable for preserving and extending understanding of complex and poorly understood activities. Products with such characteristics find it hard to enter the local market, as they lack FSAs and CSAs. Economic theory would predict that products will be purchased through the channel whose characteristics tend to minimize the transactions costs incurred due to the product features and the purchasers' endowments (Lancaster, 1966).

Retailing represents such product characteristics and consumer characteristics, as it consists of the activities involved in selling goods and services to ultimate consumers for personal consumption (Coughlan, Anderson, Stern, & El-Ansary, 2001). A higher degree of control is more efficient for technically sophisticated products and process, which tend to have a higher proprietary content than unsophisticated products (Anderson & Gatignon, 1986). Complex products and proprietary brand equity require the extensive participation of local salespersons. On the other hand, simple and standardized products do not require a high degree of control, and they typically use a common channel such as specialty stores and super stores. Local responsiveness is maximized when foreign MNEs have a good non-location bound FSA, which is matched with the host country's local responsiveness.

In addition, retailing incorporates institutional and organizational characteristics. The internal and external structure of firm has been developed to maximize performance in the market. MNEs enter new (foreign) markets where they efficiently utilize their organizational capability. The organizational capabilities are components of what we call the non-location

bound FSA. The adaptation of strategies, structures and processes to institutional idiosyncrasies has been recognized as a major challenge for managers (Meyer & Peng, 2005). Institutional relatedness, therefore, is a facilitator of local responsiveness. Stronger institutional relatedness between home and host market will increase local responsiveness. In the double diamond framework, Rugman and D'Cruz (1991) argue that strategic decisions made by managers of such MNEs are influenced to a large extent by the requirement for market access to, and competitiveness in, at least one of the triad blocks.

H7: MNEs which have good non-location bound FSAs and good local responsiveness are likely to access a foreign market.

RESULTS

Transaction Costs

All of the hypotheses are highly supported by the evidence from the Korean cosmetics industry. The market penetration strategies and the current level of internalization of cosmetics MNEs in the South Korean market are summarized in Table 1. Approximately 50% of the largest one hundred cosmetics MNEs have officially entered the South Korean market since 1964. Home based MNEs (Japanese firms) show a higher entrance rate than foreign triad based MNEs. The entry mode literature points out that market similarity makes MNEs choose a high investment mode, but the results should be modified from the perspective of regional strategy and upstream and downstream FSAs. As discussed in the previous section, because of low transaction costs, home region MNEs prefer a low level of control to balance upstream FSAs and downstream

FSAs. By concentrating their upstream FSAs, such as production and sourcing, they can maximize their economies of scale in the home country.

The evidence in panel A of Table 1 suggests that foreign region MNEs invest more when they first enter the South Korean market, in comparison to home region MNEs. Large MNEs prefer a high investment mode (such as a subsidiary) to a low investment mode (such as an alliance); see panel B of Table 1. Average sales increase with the level of control; there are three reasons. First, small MNEs have stricter budget constraints than large MNEs. Second, large MNEs usually have more absorptive capacity than small MNEs. Finally, large MNEs need to control their non-financial equity such as brand, R&D, and sales know-how etc, and this requires a higher control mode for them than small MNEs. The evidence supports H1: large MNEs prefer a high control mode to a low control mode.

Table 1 also show that Japanese cosmetics MNEs do not use WOS but generally use exporting and licensing modes when they enter the South Korean cosmetics market; this supports H2. The evidence of Japanese MNEs is consistent with the study of Makino and Beamish (1998). They find that Japanese MNEs prefer JV to WOS as an entry strategy in eight Asian countries. However, WOS is an attractive entry strategy to foreign region MNEs as well as exporting and licensing; this supports H3.

Table 1 is approximately here

After entering the host market, MNEs may change their control of subsidiaries. The development of FSAs requires a different ownership structure of subsidiaries. In our sample, seven firms have changed the level of control in the South Korean market, while 41 firms have

maintained their initial penetration strategy. Two firms (Unilever and Kanebo) have changed their control level twice; see Table 2.

Except for Louis Vuitton Moët Hennessy (LVMH), which is the only retail global MNE in the largest 500 companies (see Rugman & Verbeke, 2004), all six firms changed their level of control gradually, and this finding is consistent with Johansson and Vahlne (1977). LVMH changed its internalization strategy from trade to a WOS in the South Korean market after acquiring Guerlain and Kenzo. LVMH's sudden change in the ownership structure of its subsidiary occurred because of the change of headquarters' structure, not because of the change of host market conditions. The sudden increase in FSAs of LVMH affected the ownership structure of its subsidiary. All seven firms sell more than $1 billion over the world: their average sales, $5.5 billion in 2003, are much higher than the sample average, $1.1 billion. This evidence suggests that the capability of changing organization form needs non-location bound FSAs and supports H4: MNEs gradually increase their level of control of subsidiaries only when they have developed non-location bound FSAs (especially in size).

Table 2 is approximately here

Market Similarity

The evidence of the South Korean cosmetics industry also supports all hypotheses on market similarity. The international strategy of MNEs can be distinguished between home region strategy and foreign region strategy. In Figure 1, we classify cosmetics MNEs, which have entered South Korea, according to their nationality. In general, home region MNEs entered earlier than foreign region MNEs, and large MNEs entered earlier than small MNEs. This

supports H5 and H6. From the perspective of internalization (transaction cost) theory as well as evolutionary theory and the eclectic theory, it is obvious that market similarity of the host country provides greater incentives to home region MNEs than to foreign region MNEs. The evidence is consistent with the findings of entry mode literature as shown in the previous section.

Figure 1 is approximately here

As discussed earlier, market similarity comes not only from the regional level but also from the country, firm, and product level. Retailing also reflects the characteristics of local responsiveness. Large MNEs usually produce and retail multiple products with multiple channels, but they cannot fully replicate the channels which they use in the home country, in a host country. The host market has a different diamond from the home market, and market similarity should be examined by a double diamond framework (Rugman & D'Cruz, 1991; Rugman & Verbeke, 1993). The channel selection in the host market is affected by non-location bound FSAs (channel experience in home country) and local responsiveness (channel configuration of host country).

Table 3 presents distribution channel configurations for 11 countries. It shows that channel configurations are different across countries. For example, specialty store channels in France, South Korea and Japan are higher than other countries. Strong institutional relatedness exists between the three countries. This gives a better opportunity to firms from France and Japan than to other foreign MNEs in the South Korean cosmetics market. MNEs from France and Japan show greater local responsiveness in the South Korean market, and they will enter with a specialty store channel. On the other hand, the U.S., the U.K., German and Canadian MNEs have a home diamond advantage in the mass merchandisers and the other channels, but

this FSA would not be very effective in the South Korean market, where the mass merchandisers and the other channels account for small proportion compared to others. The U.S., the U.K., German, and Canadian MNEs need to exploit a new host diamond or need to supplement other FSAs.

Table 3 is approximately here

We use a logit regression model to test the relationship between the double diamond (local responsiveness) and market penetration. The logit regression model is widely used in entry mode literature and channel selection literature; see, among others, Kim and Hwang (1992), Agarwal and Ramaswami (1992), Li (1995), and Chen and Hennart (2002). We use 89 cosmetics MNEs from 10 countries, and each company has four observations according to channel configuration. Logit regression equation is formalizes as follows,

$$\Pr(I_{ij}) = f\left(\text{Log of } sales_i, HomeChannel_j, HostChannel_j, TriadDummies_i\right) + \varepsilon_{ij},$$

where $\Pr(I_{ij} = 1)$ is the probability that MNE *i* enters the South Korean market through marketing channel *j*.

The Binomial dependent variable is 1 when the MNE *i* entered into the South Korean market before 2003 though marketing channel *j*; otherwise it is 0. Log of sales is employed for firm specific advantage. The home country channel and host (South Korea) country portion represents home country diamond (non-location bound FSAs) and host country diamond (local responsiveness). Triad dummies, for the Asia region and Europe region, are included to help observe the regional specific advantages discussed in this paper (see also Appendix B for a correlation matrix).

The results show positive and significant relationships: see Table 4. A positive sign means that the variable increases the likelihood of a subsidiary entering with the specific channel mode. The first model contains the effects of firm size (log of sales) and regional specific advantage (region dummies). The second model includes the effects of non-location bound FSAs and local responsiveness with firm size. The third model puts all the variables together. The model is stable.

All three models are statistically significant, but log likelihood values and chi-square values confirm that the third model is a better specification than the others. The results clearly demonstrate the strategic importance of FSAs and local responsiveness (home country and host country diamond) as well as regional bound advantages. The coefficient value of the host country channel, 3.5011, is higher than the value of the home country channel, 1.2556. A small gain of local responsiveness (host country diamond) increases the likelihood of entrance more than the small gain of non-location bound FSAs (home country diamond) can do. An MNE should carefully analyze the host market diamond, and it improves the MNE's ability to adapt to the host market.

In summary, the evidence supports H7: non-location bound FSAs and local responsiveness have positive relationships with the market entry decision of MNEs. It is important to note that firm size and regional dummies are significant, and the coefficient of the Asia region dummy is, in particular, larger than the Europe region dummy and the America region dummy. This suggests that Asian (Japanese) firms are more likely to enter the South Korean market even though their FSAs and CSAs are the same as other foreign region MNEs. These results also support H5 and H6.

Table 4 is approximately here

CONCLUSIONS

This evidence from the largest cosmetics companies in South Korea, in general, supports the recent work on the regional nature of MNEs (Rugman & Verbeke, 2004; Rugman, 2005). In this study, we find that the international strategy of MNEs distinguishes between a home region strategy and a foreign region strategy. Home region MNEs' market penetration and internalization strategies are different than those of foreign region MNEs. The present analysis also supports conventional theoretical and empirical evidence that entry and expansion of MNEs are decided by a firm's resources requirements, but the conventional framework of the resource-based perspective needs to be augmented by the development of regional bound FSAs.

In this study we find that home region MNEs tend to exploit downstream FSAs, due, presumably, to the differences in transaction costs, while foreign region MNEs tend to develop upstream FSAs. MNEs gradually increase their level of control of subsidiaries and non-location bound FSAs affect the ownership structure of subsidiaries. Market similarity also gives a greater incentive to operate in their home region rather than in their foreign regions.

This study also provides an important empirical test of the "double diamond" framework (Rugman & D'Cruz, 1991; Rugman & Verbeke, 1993). Not only does the home country diamond but also the host country diamond affect the decision of market entry into the host country market. As in the double diamond theory, the host country diamond is as important as the home country for cosmetics MNEs. Firm specific advantage, proxied by firm size, significantly increases the likelihood of entering the host market. Home region (Japanese) firms

are more likely to enter the South Korean market than are foreign region MNEs (from the United States and European countries).

Two extensions come out of this study. First, although the hypotheses proposed are largely supported for the cosmetics industry in the South Korean market, there remain data limitations. Further research should generalize the results by extending the analysis to other industries including several host country markets. Second, in this article we focus on FSAs and CSAs to find the difference between home region MNEs and foreign region MNEs. Based on the perspective of evolutionary theory and eclectic theory, it would be a useful extension to further examine the relationship between the learning process and internalization advantages and to find any further differences in the strategies of home region MNEs and foreign region MNEs.

In conclusion, this study provides additional evidence in support of the regional MNE theory. Its findings agree with other single industry studies (e.g., on the retail sector, the automotive sector, etc.). We also analyze this industry in an important Asian country, which is a small, open economy in contrast to a "core" triad economy such as the E.U., the United States, or Japan. More studies that investigate different industries and countries of various sizes are needed to generalize the findings of this article on the regional importance of MNE market penetration strategy. In particular, a future comparative study of MNEs in a large, open economy and in a small, open economy will increase understanding of the institutional and macroeconomic factors affecting the regional dimension of MNEs.

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TABLE 1
The Market Penetration and Current Internationalization Strategy of Cosmetics Firms in South Korea

		Panel A. Penetration (Entry) Strategy					
Home Region		*Total*	*No Entry*	*Exporting*	*Licensing*	*Joint Venture*	*Wholly Owned*
Asia (Japan)	*Num. of Firm*	8	1	4	2	1	0
		(8.4%)	(12.5%)	(50.0%)	(25.0%)	(12.5%)	(0.0%)
Americas	*Num. of Firm*	37	23	5	1	1	7
		(38.9%)	(62.2%)	(13.5%)	(2.7%)	(2.7%)	(18.9%)
Europe	*Num. of Firm*	50	23	20	4	0	3
		(56.0%)	(46.0%)	(40.0%)	(8.0%)	(0.0%)	(6.0%)
Total	*Num. of Firm*	95*	47	29	7	2	10
		(100%)	(49.5%)	(30.5%)	(7.4%)	(2.1%)	(10.5%)

		Panel B. Current Internalization Strategy					
		Total	*No Entry*	*Exporting*	*Licensing*	*Joint Venture*	*Wholly Owned*
Asia (Japan)	*Num. of Firm*	8	1	3	0	3	1
			(12.5%)	(37.5%)	(0.0%)	(37.5%)	(12.5%)
	Sales (Avg.)	1,631	2,750	343	0	1,334	5,270
Americas	*Num. of Firm*	37	23	5	1	1	7
			(62.2%)	(13.5%)	(2.7%)	(2.7%)	(18.9%)
	Sales (Avg.)	1,269	417	968	1,300	3,750	3,926
Europe	*Num. of Firm*	50	23	19	1	0	7
					(2.0%)	(0.0%)	(14.0%)
	Sales (Avg.)	960	306	369	170	0	4,824
Total	*Num. of Firm*	95	47	27	2	4	15
			(49.5%)	(28.4%)	(2.1%)	(4.2%)	(15.8%)
	Sales (Avg.)	**1,137**	**412**	**477**	**735**	**1,938**	**4,434**

Sources: Data of penetration and internalization strategies are from Jang-up newspaper; sales data are from annual reports, World Scope, and COMPUSTAT.
Notes: Excluding 5 Korean firms. Sales are total global sales in 2003. When MNEs use different market strategy for different products categories, we select strategy for main products.

Table 2
Establishment Patterns for and the Changing Level of Control

Entry Strategy → *Current Strategy*	*Exporting* → *Licensing*	*Exporting* → *Joint Venture*	*Exporting* → *Wholly Owned*	*Licensing* → *Joint Venture*	*Licensing* → *Wholly Owned*	*Joint Venture* → *Wholly Owned*
Number of firms	1	1	1	2	3	1
Years to Switch Mode	6	6	10	6	20	8
Firm Name	Kanebo	Kanebo	LVMH	Unilever Kose	L'Oréal Shiseido Bierdorf	Unilever

Source: see sources in Table 1.
Note: This is adapted from Johansson & Vahlne (1977).

Table 3
Channel Configuration in Cosmetics and Toiletries Products

Distribution Channel	*Brazil*	*Canada*	*France*	*Germany*	*Italy*	*Japan*	*Korea*	*Russia*	*Spain*	*UK*	*US*
Direct Sales	24.7	12	8.0	3.4	4.0	10.7	23.1	8.8	1.6	5.1	7.9
Specialty Store	13.8	4.8	20.6	11.7	29.7	20.7	37.9	12.5	7.9	5.5	8.1
Mass Merchandisers	47.3	57.4	60.0	61.2	53.6	41.7	34.0	55.3	57.3	49.9	58.8
Others	14.2	25.8	11.4	23.7	12.7	26.9	5.0	23.4	33.2	39.5	25.2

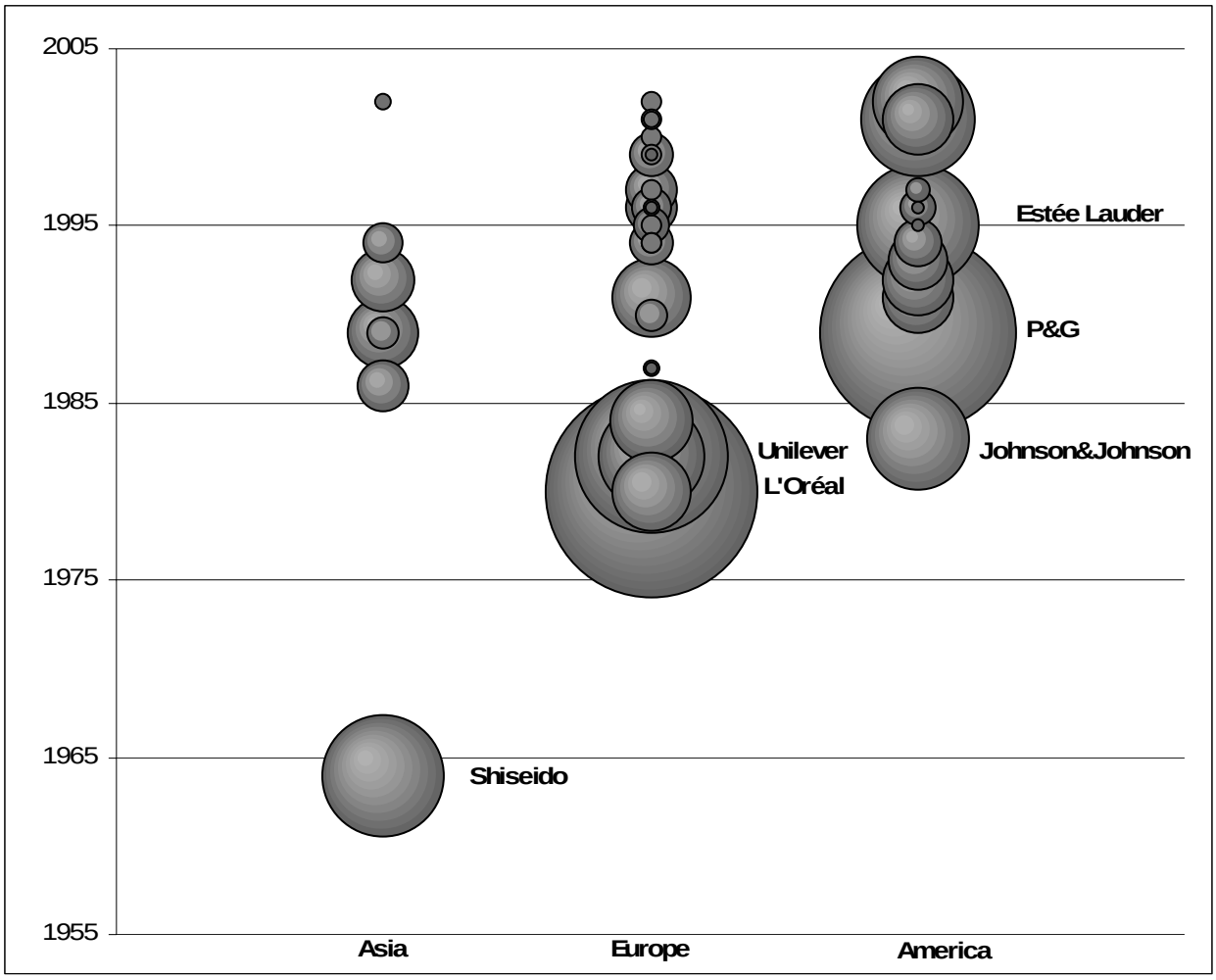
Source: Euromonitor (2003, Electronic edition) *Market Research Monitor*.

Table 4
Logistic Regression Results

Variables	*Mean (s.e)*	*(1)*	*(2)*	*Model (3)*
Constant	n.a.	-4.9902***	-5.5352***	-6.4551***
		(0.6803)	(0.7513)	(0.8558)
Log of Sales	5.8579	0.4820***	0.4801***	0.5089***
	(1.5475)	(0.0943)	(0.0906)	(0.0966)
Home Country Channel	0.2500		1.2119*	1.2556*
	(0.1991)		(0.6421)	(0.6745)
Host Country Channel	0.2500		3.3873**	3.5011**
	(0.1278)		(1.3339)	(1.3704)
Asia (Japan) Region	0.0899	1.2737***		1.3406***
	(0.2864)	(0.4581)		(0.4676)
Europe Region	0.4943	0.9885***		1.0238***
	(0.5007)	(0.3214)		(0.3303)
Number of Obs.		356	356	356
Log likelihood		-160.07	-159.57	-152.77
Chi-square		36.80	36.00	44.46
(Prob > χ^2)		(0.0000)	(0.0000)	(0.0000)

Notes: Robust standard errors are in parentheses. Total number of MNEs in the regression is 89.
The dependent variable is market entry, which has dichotomous values: enter (1) and not enter (0).

Figure 1
Triad Regions and Market Penetration



Source: see sources in Table 1.
Note: The size of bubble is total global cosmetics sales in 2003, ranging from Riviera Concepts (smallest dot, $59 million) to L'Oréal Group (largest dot, $15.5 billion).

Appendix A

List of largest 100 cosmetics companies and their home region sales and assets

Company	Home Country	Home Region	Sales in million US$	Sales		Assets	
				% intra regional	Category	% intra regional	Category
L'Oréal Group	France	Europe	15,500	52.1	D(Q)	53.0	D(Q)
P&G	U.S.	America	13,000	57.0	A	53.6	A
Unilever PLC	U.K.	Europe	8,070	50.3	C	50.3	C
Shiseido CO.LTD	Japan	Asia	5,270	82.1	A	70.3	A
Estée Lauder Cosmetics Inc.	U.S.	America	5,100	57.7	A	67.8	A
Avon Products Inc.	U.S.	America	4,490	62.6	A	51.2	C(Q)
Beiersdorf AG	Germany	Europe	3,790	75.1	A	80.1	A
Johnson & Johnson	U.S.	America	3,750	65.7	A	73.8	A
Alberto Culver Co.	U.S.	America	2,750	77.1*	A	68.6*	A
Kao Corp.	Japan	Asia	2,750	82.8	A	78.7	A
Limited Brands	U.S.	America	2,600	na		na	
LVMH Louis Vuitton	France	Europe	2,470	38.0	D	na	
Chanel	France	Europe	2,240	na		na	
Colgate Palmolive	U.S.	America	2,200	60.2	A	59.0	A
Henkel KGAA	Germany	Europe	2,140	75.0	A	68.9	A
The Boots Company PLC	U.K.	Europe	2,030	96.4*	A	96.0*	A
Mary Kay Inc.	U.S.	America	1,800	na		na	
Alticor Inc.	U.S.	America	1,800	na		na	
Yves Rocher	France	Europe	1,720	na		na	
Coty Inc.	U.S.	America	1,700	33.0	B	na	
Kanebo	Japan	Asia	1,680	na		na	
Kose Corp.	Japan	Asia	1,440	90.0*	A	90.0*	A
Revlon Inc.	U.S.	America	1,300	64.4*	A	83.3*	A
Amorepacific Corp.	Korea	Asia	1,090	na		na	
Sara Lee Corp.	U.S.	America	1,080	68.8	A	81.7	A
Group Clarins	France	Europe	1,000	78.4	A	93.1	A
Puig Beauty and Fashion	Spain	Europe	990	73.0	A	77.8	A
Pola Cosmetics Inc.	Japan	Asia	881	na		na	
Gillette Co.	U.S.	America	864	na		na	
Elizabeth Arden Inc.	U.S.	America	814	77.0	A	95.5	A
Oriflame Cosmetics	Sweden	Europe	738	90.8	A	98.2	A
Gucci Group (PPR)	Netherlands	Europe	696	43.8	D	81.1	A
Group Pierre Fabre	France	Europe	687	57.3*	A	94.4*	A
The Body Shop	U.K.	Europe	623	71.1	A	81.3	A
Nippon Menard Cosmetics	Japan	Asia	570	na		na	
Euroitalia Group	Italy	Europe	504	na		na	
LG Household and Health	Korea	Asia	495	97.2	A	99.2	A
Nu Skin Enterprises Inc.	U.S.	America	476	16.0	B		
Colomer Beauty and Prof.	Spain	Europe	450	na		na	
Clayton Dubilier and Rice	U.S.	America	400	na		na	
Sisley	France	Europe	373	na		na	
Noevir Co. LTD	Japan	Asia	355	90.0*	A	90.0*	A
Markwins International	U.S.	America	325	na		na	
DEL Laboratories	U.S.	America	310	95.0*	A	na	
Tigi	U.S.	America	250	na		na	
IWP	Ireland	Europe	206	86.9*	A	na	
Liz Claiborne	U.S.	America	200	77.9*	A	na	
Inter Parfums	U.K.	Europe	186	50.0	C	74.2	A
Kelemata Group	France	Europe	181	na		na	
L'occitane	France	Europe	175	na		na	
Mirato SPA	Italy	Europe	175	90.5	A	na	
Guaber Group	Italy	Europe	170	na		na	
Ales Group	France	Europe	170	62.0	A	83.8	A
Johnson Publishing	U.S.	America	170	na		na	

Company	Home Country	Home Region	Sales in million US$	% intra regional	Sales Category	% intra regional	Assets Category
Eugene Perma	France	Europe	168	na		na	
Coreana	Korea	Asia	159	97.9*	A	100.0*	A
Diana De Shilva	Italy	Europe	158	na		na	
Bulgari Parfums	Swiss	Europe	155	45.0	C	na	
Combie INC.	U.S.	America	154	na		na	
Micys (pupa)	Italy	Europe	149	na		na	
Maxim Marken	Germany	Europe	147	na		na	
O Boticario	Brazil	America	147	na		na	
Schering-Plough	U.S.	America	146	na		na	
Von Berg Cosmetics	U.S.	America	137	na		na	
Laboratoires Sarbec	France	Europe	130	70.0*	A	100.0	A
Kalina	Russia	Europe	126	na		na	
Deborah Group	Italy	Europe	125	na		na	
Maurer + Wirtz	Germany	Europe	122	na		na	
Playtex Products	U.S.	America	119	89.2*	A	96.5*	A
Parfums de Coeur	U.S.	America	118	na		na	
Diamond Products	U.S.	America	113	na		na	
Lush LTD.	U.K.	Europe	112	na		na	
Versace Profumi	Italy	Europe	110	na		na	
Sony Culture Ent.	Japan	Asia	105	na		na	
Paglieri Profumi	Italy	Europe	102	na		na	
Weleda AG	Swiss	Europe	102	na		na	
Doctor Babor	Germany	Europe	101	na		na	
MD Beauty	U.S.	America	100	na		na	
Financiere Richemont SA	Swiss	Europe	95	43.2	D	na	
Collistar	Italy	Europe	93	na		na	
Tupperware	U.S.	America	91	92.3	A	93.8	A
Marbert	Germany	Europe	84	79.1*	A	na	
Parlux Fragrance	U.S.	America	81	64.8*	A	na	
Jacques Bogart	France	Europe	80	na		na	
Tanning Research	U.S.	America	79	na		na	
Artdeco	Germany	Europe	78	na		na	
Weruska & Joel SRL	Italy	Europe	76	na		na	
Fribad	Germany	Europe	74	na		na	
Hankook	Korea	Asia	72	98.0*	A	100.0*	A
Guinot Group	France	Europe	71	na		na	
Murad	U.S.	America	67	na		na	
Mana Products	U.S.	America	65	na		na	
Alcina Kosmetik	Germany	Europe	63	na		na	
Hermes	France	Europe	61	na		na	
Riviera Concepts	Canada	America	59	na		na	
Parfume Parlour	France	Europe	56	na		na	
Russkaya Kosmetika	Russia	Europe	55	na		na	
Charmzone	Korea	Asia	54	na		na	
Crabtree and Evelyn	U.S.	America	52	na		na	
Perricone MD	U.S.	America	52	na		na	

Source: Geographic dispersion data for sales and assets comes from annual reports, World Scope, and COMPUSTAT. Data of four companies, P&G, KAO, Pierre Fabre, Noevir, are unavailable for 2003, so 2004 data are used in these cases.

Notes:

a. Sales are total cosmetics sales in 2003 from WWD.

b. A, B, C, and D represent Home region oriented, host-region oriented, Bi-regional, and Global multinationals respectively.

b.* indicates portion of Home-country sales (assets) respect to total sales (assets).

d. (Q) indicates Quasi-; Quasi global MNE means that two host regions have more than 20 % of sales (assets) for each foreign region, but home region sales (assets) is slightly more than 50 %. L'Oréal's geographic dispersion of sales consist of 52%, 28% and 20% for Europe, America and Asia respectively, and it is categorized as quasi global MNE in the sense of sales. Quasi bi-regional MNE means that only a host region has more than 20 % of sales (assets), but home region sales (assets) is slightly more than 50 %. Avon's geographic dispersion of assets consist of 32%, 51% and 17% for Europe, America and Asia respectively, and it is categorized as quasi bi-regional MNE in the sense of assets.

Appendix B
Correlation Matrix for variables used in the logistic regression

Variables	1	2	3	4	5	6
1 Entry						
2 Log of Sales	0.29**					
3 Home Country Channel	0.16**	0.00				
4 Host Country Channel	0.13**	0.00	0.23**			
5 America Region	0.07	-0.17**	0.00	0.00		
6 Asia (Japan) Region	-0.16**	0.05	0.00	0.00	-0.83**	
7 Europe Region	0.16**	0.21**	0.00	0.00	-0.31**	-0.27**

Notes: N=356, **$P < 0.01$